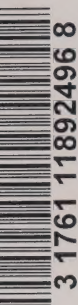


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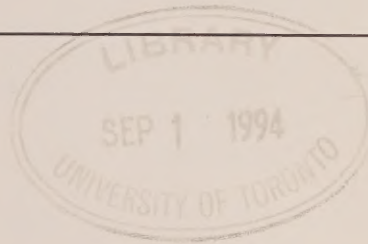
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Alcohol and Tobacco Taxes: A Public Health Priority

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Over the past decade, public concern about the perceived epidemic of illegal drug use has escalated. Yet two of the most common legal drugs of all – tobacco and alcohol – cause more destruction than all the illegal drugs combined.

Every year, 39,000 Canadians die from smoking – roughly 100 times the number who die as a direct consequence of illicit drug use. Tobacco is a major cause of heart disease, stroke, cancer and respiratory disease and contributes to peripheral vascular disease, peptic ulcers and fetal damage.

Alcohol abuse has its own unique costs. Last year, the deaths of about 19,000 Canadians were directly or indirectly related to alcohol abuse, including traffic fatalities and alcohol-related diseases such as liver cirrhosis. In Ontario alone, about 640,000 people report some physical, social or health-related harm resulting from their own drinking.

From a public health perspective, the harmful effects of alcohol and tobacco consumption are clearly a major concern. A wide range of measures have been proposed or adopted to control these effects: tax increases, advertising restraints, production controls, education programs, and restrictions on age of purchase. That many of these measures are government initiatives suggests the breadth of influence that legislators can have on public health. This is particularly true of tax increases, one of the most effective methods of control.

HISTORY OF ALCOHOL AND TOBACCO TAXES

Taxing alcohol and tobacco is an almost universal practice. It is a well-established means of raising government revenue because alcohol and tobacco have traditionally been seen as luxury commodities.

More recently, however, the use of tax increases is increasingly seen as a method of reducing health risks as well.

In the case of tobacco, Canada's comprehensive strategy to reduce consumption, including tax increases as a major component, has resulted in large decreases in smoking in Canada. Despite the government's growing willingness to use tax increases as a means of controlling consumption, however, tobacco taxation has not kept pace with inflation until recently so that, relative to other commodities, the real price has declined, compared to pre-1950 levels.

Current public policy initiatives in Canada on alcohol are not as comprehensive as those on tobacco. However, the existing control structure for alcohol, which in this province includes the Liquor Control Board of Ontario (LCBO) and the Liquor Licence Board of Ontario (LLBO), is fairly strong by international standards. Furthermore, there is pressure from a number of organizations, including the ARF, to expand alcohol controls by such measures as a legislated ban on television ads by brewers and vintners as well as distillers.

Indeed, until recently, modern public health initiatives have tended to focus more on the hazards of tobacco than on alcohol, in part because policy makers have been reluctant to associate themselves with any position or action that seemed to smack of the Prohibition era. The backlash against the temperance movement led to the view that alcohol was only a problem for "alcoholics" and treatment the only appropriate solution. As for "normal drinkers," the risk of alcohol-related problems was virtually ignored.

Over the past two decades, however, research has shown that alcohol-related risks affect all of society and that there is a relationship between overall use and rates of health problems. As a result, thinking about the role of alcohol in public health has undergone a major change. There has been growing interest throughout the world in the use of alcohol controls such as tax increases to reduce alcohol-related problems.

THE CASE FOR TAX HIKES

Simply put, raising taxes on cigarettes or alcohol reduces the overall level of harm to health due to their use. This is true even though consumption of either is not very price elastic.

Price elasticity is a measurement of the relationship between price and consumption. By and large, alcohol and tobacco behave like other commodities; that is, demand for a product goes down as price goes up. This response is termed either elastic or inelastic, depending on the degree to which demand is influenced by price. For example, demand is said to be price elastic if a 10 per cent change in price produces more than a 10 per cent change in consumption; inelastic if consumption changes by less than 10 per cent. (However, the terms 'elastic' and 'inelastic' are themselves relative. Even though a

commodity may be considered inelastic in economists' terms, demand will nevertheless respond to changes in price, but within a more limited range.)

The demand for both alcohol and tobacco is responsive to incremental changes in price although the potential impact of a change in the price of alcohol will be influenced by any other changes in availability. For example, the effect of any price increase may be lessened if, at the same time, there is widespread expansion of outlets, unrestrained advertising and lax enforcement of regulations. Tax increases must be seen as one important element of a larger public health strategy.

Elasticity also varies by beverage type. The demand for beer, the most popular beverage in Canada, is not very elastic. The demand for wine and spirits, on the other hand, is a little more responsive to price changes.

All three categories of beverages are probably more elastic for young people. Tobacco is also more elastic among young people than among adults. Tax increases, then, will especially affect the drinking or smoking behaviour of young people.

But since the demand for these products is relatively inelastic for the general population, an increase in price would not reduce consumption to the point where overall tax revenues would suffer. This is advantageous for governments which rely on taxes to raise revenue. In fact, in terms of government revenue, the size of the price elasticities for beer, wine and spirits are all within the optimum range – where consumption will fall but revenues will actually rise.

Alcohol: Tax increases reduce consumption not just by social drinkers but also by heavy drinkers and chronic alcoholics. There is also growing evidence that the price of alcohol influences not only overall alcohol consumption, but levels of alcohol-related problems as well. Rates of both road accidents and liver cirrhosis deaths have been shown to relate to changes in the price of alcohol.

The current Ontario alcohol tax structure reflects the widely-held view that drinking beer and wine is inherently more temperate than drinking spirits; that beer, in particular, is the "drink of moderation." Taxes account for about 82 per cent of the price of spirits, 69 per cent of wine and 53 per cent of beer.

A few alcohol-related problems are indeed more likely to occur with one type of beverage than with another; in particular, it is easier to overdose on spirits than on beer. But such problems are a very small part of all alcohol-related problems. Broadly speaking, in terms of public health consequences, "a drink is a drink is a drink" whether it is beer, wine or spirits.

The most appropriate tax strategy may therefore be to tax alcoholic beverages so as to equalize the price according to the pure alcohol content. Currently, the consumer pays more for the alcohol in spirits and wine than for the same amount in the form of beer. For example, if he were paying a dollar for the absolute alcohol contained in a bottle of beer, he would be paying about \$1.25 for the same amount of alcohol in the form of wine, and \$1.32 in the form of whisky.

Tobacco: Because young people have little money, demand among this group is more strongly influenced by price than demand among adults. Based on analysis of Canadian data, a 10 per cent increase in the relative price of cigarettes (over and above inflation) would likely result in a 17 per cent decrease in cigarettes consumed per capita by 15 to 19 year olds.

Effects of larger increases are more speculative: a 50 per cent increase, for example, could result in decreases of over 80 per cent in per capita consumption by young people. These measures apply only to the price and consumption patterns recorded in the 1980s. If prices were raised substantially in the 1990s, we might see even larger effects. Changing attitudes towards tobacco use, the decline of smoking among parents who are important role models for children, and increased regulation of smoking in schools and other public places play an important role in the potential impact of tax increases.

However, even though smoking among both adults and adolescents has dropped steadily over the past 10 years, recent reports of a 13.5 per cent increase in smoking among college freshmen in the U.S. suggest this pattern could yet be reversed in Canada. Continuing substantial increases in taxation over and above the rate of inflation may be necessary to prevent the reversal of the recent decline in smoking among adolescents.

COMPARING ONTARIO WITH THE REST OF CANADA

Alcohol: Ontario's taxes for alcohol are among the lowest in Canada. In 1989, Ontario collected \$14.34 per litre of absolute alcohol. (One litre of absolute alcohol is equal to about 59 bottles of beer, 11 bottles of table wine or about three bottles of spirits.) Only Quebec collected less, at \$9.74 per litre. The rate in British Columbia, at \$15.68, was not much higher than Ontario's. It seems ironic that two of Canada's wealthiest provinces should have among the lowest alcohol prices in the country while the other seven provinces, along with the Yukon and the Northwest Territories, collect much higher taxes, averaging \$22 per litre.

Tobacco: The increase in Ontario's tobacco tax in 1991 was accompanied by roughly similar increases in eight of the other nine provinces. As a result, Ontario's tax on cigarettes remains 16.3 per cent lower than the average of all other provinces. Taking the provincial sales tax into account, the total tax on cigarettes in Ontario is still 11.1 per cent lower than the average of all other provinces.

THE CONSUMER PRICE INDEX

One issue facing Canadian legislators is whether to tie alcohol and tobacco taxes to the consumer price index, or CPI. The CPI is a measure used by economists as an indirect means of calculating the rate of change in the prices of a range of generic consumer goods. If tax increases on alcoholic beverages, for example, are tied to the CPI, the final retail price of alcohol will automatically keep pace with the rate of inflation, keeping its real cost constant relative to that of other goods.

Alcohol was tied to the consumer price index in Ontario until the late 1970s, when this linkage was dropped as an anti-inflationary measure. As a result, there is no longer any guarantee that the price of alcohol will continue to rise along with that of other goods. However, the LCBO continues to make indirect efforts to control consumption through pricing. Indeed, this has become one of the main points of contention in the General Agreement on Tariffs and Trade. With increasing subsidization of foreign agriculture and an over-production of foreign wine, foreign suppliers are prepared to offer wholesale prices below the LCBO floor price. Such prices mean not only increased competition for domestic suppliers, but probably increases in consumption.

Currently, alcohol is a little less than half the cost in relative terms that it was in 1949/50. At that time, ten litres of absolute alcohol (about 200 bottles of beer in a year – or about half a beer a day) cost the average Ontario adult about 5.5 per cent of their personal disposable income. By 1985, it had dropped to just over two per cent.

Unlike alcohol, tobacco has never officially been tied to the CPI. But in the case of tobacco, the gap between 1949 and current levels is not nearly as large as it is with alcohol. Nevertheless, although price increases of late have more than kept pace with inflation, cigarettes today, at about five dollars for a pack of 20 and six dollars for a pack of 25, still cost slightly less in real terms than they did in 1949.

However, it may be in the best interest of public health to increase alcohol and tobacco taxes faster than CPI increases would allow. Recent increases in tobacco taxes which exceeded the current rate of inflation ensured a larger drop in consumption than would have been the case had the tax increase only matched the rise in the cost of living.

ECONOMIC IMPACT OF THE TOBACCO AND ALCOHOL INDUSTRIES

A frequent argument made against raising alcohol or tobacco taxes is that reduced consumption means reduced employment in the tobacco and alcohol industries and a reduced contribution to the economy. Both alcohol and tobacco production are highly automated, so their direct contribution to employment is limited. Alcohol and tobacco manufacturers typically respond to tax increases by increasing their margin at the same time, so that the revenue and profits of the industry need not be affected by the decline in consumption.

Most of the employment associated with alcohol and tobacco sales is at the retail level, often in the form of a small part of the worker's job – cigarette sales in a corner store, or alcoholic drinks with a restaurant meal. A fall in consumption of alcohol or tobacco will affect these jobs, but any decline will tend to be balanced by the increased sales of other products as consumers use the money they have saved by drinking or smoking less.

Even if there were a net loss to the economy or to employment from reducing tobacco or alcohol sales, this must be balanced against the benefit from the reduction in

the health and social costs of smoking or drinking. The balance should not be drawn only in economic terms.

Reduced alcohol or tobacco sales means not only a reduction in hospital stays, disability days and other economic costs, but also in human suffering from such consequences as illness and premature death.

WHO'S AFFECTED BY TAX HIKES?

Obviously, those who choose not to smoke cigarettes or drink alcoholic beverages do not pay any taxes on them. Those who do drink or smoke pay roughly in proportion to the amount they use. Heavy consumers are therefore those most affected by tax hikes. For both alcohol and tobacco, less than a quarter of the adult population is paying the bulk of the taxes.

For tobacco, these high volume users are more likely to be poor than affluent. For alcohol, the affluent drink more on the average than poorer people. Even for alcohol, however, the affluent spend a smaller proportion of their income on drinking than poorer people do. In this sense, both alcohol and tobacco taxes *are* regressive.

But these taxes *are* appropriately targetted in terms of public health interests. The taxes are an incentive to cut down on smoking and drinking, and the highest incentive is for the heaviest smokers and drinkers. Studies show that, in fact, heavy users are affected by such price incentives at least as much as lighter users.

Furthermore, the heavy users cost the government considerably more than others in health care and other costs due to their drinking or smoking. Alcohol and tobacco taxes can thus be seen as an equitable way of financing these extra costs due to smoking and drinking.

Lastly, the regressiveness of alcohol and tobacco taxes can be offset by how the revenues are used. If the revenues are used primarily to benefit the poor, the net effect will be progressive.

CONCLUSION

The issue of tax increases has been discussed here solely from a public health perspective. Other perspectives need to be taken into account in establishing tax levels. We have argued that in this instance, the government's fiscal

interests point in the same direction as public health interests – towards increasing taxes. But other interests and considerations will tend to pull in the other direction. Many of those who choose to drink or smoke derive pleasure from it. Drinking, in particular, is deeply embedded in the lifestyles of many people. In a democratic society responsive to minority as well as majority concerns, these preferences will tend to limit the maximization of public health interests. Another factor at extreme levels of taxation might be the creation of a substantial illicit market, with the social costs that entails.

But such factors still allow substantial scope for government action on alcohol and tobacco taxes. Also, public support for increases in taxes can be strengthened by raising public awareness of their positive consequences for public health. Following are some options that governments have considered or taken as guides to action on alcohol and tobacco taxes.

OPTIONS

1. *Counteracting past inflation:*

Bringing alcohol or tobacco taxes up to the same inflation-adjusted level as in the past, e.g. in 1950.

2. *Setting future tax policy:*

(a) Indexing alcohol or tobacco taxes to the consumer price index, so that they are not reduced by future inflation; and/or:

(b) Deciding on a schedule of regular tax increases over and above the rate of inflation.

3. *Tying taxes to harm potential:*

(a) Phasing in tax changes so that the price for the same amount of alcohol will be equal, whether the alcohol is in the form of beer, wine or spirits;

(b) Equalizing the tax treatment of different forms of tobacco (eliminating the present preferential tax treatment of fine-cut tobacco used in self-rolled cigarettes); and/or:

(c) Setting tobacco taxes on a basis of tar content, so that as far as possible, the price for the same dose of tar will be equal, in whatever form it is taken.

March 1992

